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TAGS: ENRG ECON PREL PK
SUBJECT: PAKISTAN'S GOVERNMENT INCREASES FUEL, ELECTRICITY PRICES

Summary

¶1. (SBU) Summary: The Government of Pakistan (GoP) increased fuel prices and electricity tariffs March 1 to stem the growing fiscal deficit due to subsidizing the growing differential between domestic Pakistani prices and international fuel prices. Pakistan's last fuel price increase was in February 2007. According to the Finance Minister, two to three similar price rises would be needed in the next 12 to 18 months to eliminate fuel subsidies. Our calculations differ: oil prices will need to be increased by 7-10 percent three times and electricity tariffs four times by nine percent in order to eliminate subsidies in the remaining four months of the fiscal year. End summary.

Caretaker Government finally raises prices

¶2. (U) Pakistan's caretaker government took a much delayed but crucial decision February 29 to increase gasoline and electricity prices effective March 1, 2008. Despite large increases in international prices, domestic prices were kept unchanged because of the GOP's unwillingness to raise prices before the national elections. Prices were last increased in February 2007. According to the Oil and Gas Regulatory Authority, the Government has now increased the price of regular gasoline by 9.31 percent to Rs. 58.70 ($0.94) per liter, high octane gasoline by 7.7 percent to Rs. 69.88 ($1.12) per liter, kerosene oil by 9.93 percent to Rs. 38.73 ($0.62) per liter and light diesel oil by 10.7 percent to Rs. 36.07 ($0.58) per liter. Electricity tariffs increased nine percent per unit for the eight distribution companies' average tariff of Rs. 4.50 ($0.072) per unit.

¶3. (SBU) The GOP spent a total of $1.9 billion in fuel and electricity subsidies from July 1, 2007 through February 29, 2008. Gasoline subsidies paid through February 29 were Rs. 80 billion ($1.28 billion) and power subsidies were Rs. 19.3 billion ($309.29 million). The March 1 price increases will allow the GoP to save Rs. 12.2 billion ($195.51 million) in oil subsidies and Rs. 9.1 billion ($145.83 million) in power subsidies during the remaining four months of the fiscal year.

¶4. (SBU) Finance Minister Salman Shah said at a March 1 press conference that the increase in gasoline prices will help reduce the oil subsidy by Rs. 3 billion ($48 million) per month. He added that this decision was made following consultations with the principal political parties. (Comment: Pakistan People's Party is trying to distance itself from the March price increases. End comment.) Gasoline and electricity tariff increases were necessary given the rise in international oil prices to $103 per barrel.

¶5. (SBU) The Ministry of Finance estimates that these rate hikes will increase inflation by 1.5 percent. Shah added that "the caretaker government took this step so that the new government would not have to raise energy prices right after taking office." He added that the new government should raise prices either two to three times in the next 12 to 18 months or increase revenue collection to offset the effect of subsidies. (Comment: He omitted to add that if these three price increases were made now, only then it would offset the effect of subsides for the remaining four months of the year, not the entire year. End comment.)

Comment

¶6. (SBU) Energy rate hikes are long overdue, as the 2.5 percent growth in the budget deficit is largely due to the increased cost of energy subsidies following the rapid rise in international oil prices. Our calculations show that energy prices will need to increase even more than the Finance Ministry indicates to eliminate the subsidies after February 2008. We believe that the oil price hike should have been three times and power rates increase four times if the GoP intended to pass on the entire cost of oil and power subsidies in the remaining four months of the current fiscal year.

¶7. (SBU) Comment continued: With inflation already running at 8.6 percent, well above the target of 6.5 percent, it will be difficult for a new government to phase in additional price hikes quickly. Had the government phased in the entire price increases beginning five months ago, it would have avoided running a sizable fiscal deficit, increased borrowing from the State Bank of Pakistan and other sources, and a significant decrease in reserves. Analysts, however,

believe that the magnitude of the rise will increase overall prices in unrelated areas, and that the overall impact is likely to be much higher than 1.5 percent.

¶8. (SBU) Comment continued: Raising the fuel prices in relation to international oil prices is a welcome step, but the GOP could have gotten more bang for its buck. If the price rises were passed on sooner, the increases would have been smaller and government savings in subsidies much higher. Secondly, the domestic price differential between gasoline and diesel is significant. Diesel is largely used in public transportation and luxury vehicles. Both diesel and gasoline have the same energy value. The GoP should try and equal retail prices by increasing diesel prices by a higher percentage and reducing gasoline prices nominally. As a result, the GoP diesel sales tax revenues would increase, and diesel operators would be encouraged to convert their vehicles from diesel to environmentally safe compressed natural gas and gasoline. End comment.

Patterson